United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-6066

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION,

Applicant-Appellant,

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MORGAN, KENNEDY & CO., INC.; IRWIN RUDNET and GERALD RUDNET,

Defendants-Appellees.

CLAIM OF READING BODY WORKS, INC. PROFIT SHARING PLAN TRUST,

Claimant-Appellee.

On Appeal from the United States District Court for the Southern District of New York

B

P/S

BRIEF OF APPELLEE, EUGENE L. BONDY, JR. TRUSTEE FOR THE LIQUIDATION OF MORGAN KENNEDY & CO., INC.

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SECURITIES INVESTOR PROTECTION CORPORATION,

Applicant-Appellant,

SECURITIES AND EXCHANGE COMMISSION, No. 75-6066

Plaintiff,

-against-

MORGAN, KENNEDY & CO., INC.; IRWIN RUDNET; and GERALD RUDNET;

Defendants-Appellees,

CLAIM OF READING BODY WORKS, INC. PROFIT SHARING PLAN TRUST,

Claimant-Appellee.

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BRIEF OF APPELLEE

EUGENE L. BONDY, JR.

TRUSTEE FOR THE LIQUIDATION OF MORGAN,

KENNEDY & CO., INC.

PRELIMINARY STATEMENT

This brief is submitted on behalf of Eugene L. Bondy, Jr., (the "Trustee"), Trustee for the liquidation of Morgan, Kennedy & Co., Inc.

(the "Debtor") in opposition to the appeal of the Securities Investor Protection Corporation ("SIPC") taken from a Memorandum Order of Honorable Marvin E. Frankel (the "Memorandum Order") entered on June 10, 1975 (CCH Fed. Sec. L. Rep. ¶95,228) affirming the Order of Bankruptcy Judge Roy Babitt entered in the captioned proceeding on February 14, 1975 (opinion reported at CCH Fed. Sec. L. Rep. ¶94,972) both concluding that the claim by the Trustees (the "Reading Trustees") of the Reading Body Works, Inc. Profit Sharing Plan Trust (the "Trust") for $133,051.15 be considered the separate claims of the 108 individual beneficiaries of the Trust. The opinions are reprinted in the Appendix (A 50-60).

STATEMENT OF ISSUE PRESENTED FOR REVIEW

The sole issue presented by this appeal is whether, under Section 6(c)(2)(A)(ii) (15 U.S.C. § 78 fff(c)(2)(A)(ii)) of the Securities Investor Protection Act ("SIPA") each of the individual beneficiaries of the Trust is a separate "customer" and thus each entitled to the maximum coverage provided for in Section 6(f) of SIPA.

STATEMENT OF FACTS

The facts involved in this case are not in dispute (Memorandum Order at A 58). The issue presented herein is one of law concerning the definition of "customer" under SIPA.

In 1957 Reading Body Works, Inc. ("Reading") established the Reading Body Works, Inc. Profit Sharing Plan ("Profit Sharing Plan"). Pursuant to this plan a trust fund was established and maintained through yearly employer contributions based upon Reading's net earnings. The Profit Sharing Plan provides that each Reading employee accumulates "credits" or a percentage interest in the fund according to annual compensation level and consecutive years of service. A separate account is maintained in the records of the Trust for each such employee to which is credited the applicable share of Reading's yearly contributions as well as a share of any increase in the market value of the fund. Each employee has a non-forfeitable vested interest in the amounts allocated to his account, which is received, according to certain conditions, upon termination of employment with Reading.*

The Reading Trustees established an account with the Debtor in December 1972. Following the commencement of the liquidation proceedings they filed a claim with the Trustee for $133,051.15 representing a free credit balance in that amount in the Trust's account on the date of bankruptcy. (See Exhibit A to the Trustee's Application at A 3).

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* Trustee's Application (the "Trustee's Application") dated September 5, 1974 (A 3). See also, Memorandum Opinion of Bankruptcy Judge Roy Babitt (the "Babitt Opinion") (A 50).

The amount and validity of the claim was not in dispute below.*

SIPC was created by Congress for the purpose of providing insurance protection to the customers of broker-dealers forced into liquidation. SIPA provides that SIPC will advance insurance funds to the liquidating trustee for distribution to customers entitled to protection. Section 6(g) of SIPA imposes upon the Trustee the duty "to discharge promptly . . . all obligations of the debtor to each of its customers . . . whether or not such customer shall have filed formal proof of claim."

The Trustee notified SIPC that he intended to treat each of the 108 individual beneficiaries of the Trust as a separate customer for purposes of the limit to recovery specified in Section 6(f) of SIPA. He therefore requested that SIPC advance to him the full amount of the claim. Since one of the beneficiaries had an interest in excess of $20,000, an advance of $132,880.60 would have been required.

Section 6(f) of SIPA provides a maximum of $50,000 coverage for each customer claim based upon securities left with a bankrupt broker-dealer. Claims on account of cash are only insured up to $20,000

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* Two questions raised below by the Reading Trustees (i.e., whether the claim of the Trust should be deemed the separate claims of the three Reading Trustees and the extent to which the Trust's claim was one for securities rather than cash) (See Application of Charles M. Solomon dated October 14, 1974 at A 22) were not reached in either the Babitt Opinion or the Memorandum Order. Accordingly, they will not be discussed in this brief.

per customer. Since the Trust's claim was based on a cash credit balance, the Trustee believes each beneficiary is entitled to a maximum of $20,000 of coverage.

SIPC declined to treat the claim of the Trust as the separate claims of 108 individual customers of the Debtor but instead chose to treat the claim as that of one customer and offered to advance only $20,000.

On September 5, 1974 the Trustee made application (Trustee's Application at A 2) to Bankruptcy Judge Babitt for an order designating the claim of the Reading Trustees to be the individual claims of the 108 beneficiaries of the Trust and declaring each such beneficiary a separate "customer" within the meaning of Section 6(c)(2)(A)(ii) of SIPA and thus each entitled to the $20,000 maximum coverage provided in Section 6(f) thereof.

On February 14, 1975, Bankruptcy Judge Babitt signed the order requested by the Trustee (A 55) and on June 10, 1975 District Judge Frankel affirmed that order (A 58).

APPELLEE'S CONCLUSION

Neither the statute nor SIPC's rules refer specifically to the fact situation of these trust beneficiaries. The position taken by the Trustee herein and adopted by both Bankruptcy Judge Babitt and District Judge Frankel offers fair and equitable treatment to the 108 beneficiaries

of the Trust. As courts of equity,* both have looked to the policies underlying SIPA (in particular, the full protection of small investors) in reaching their decisions. This Court should affirm these decisions and permit the Trustee to satisfy the claims of these beneficiaries.

ARGUMENT

POINT I

THE PLAIN LANGUAGE OF SIPA WHEN INTERPRETED ACCORDING TO THE CONGRESSIONAL INTENT REVEALED IN ITS LEGISLATIVE HISTORY, ANALOGOUS FEDERAL LEGISLATIVE SCHEMES AND SIPC'S OWN RULES, REQUIRES THAT EACH OF THE 108 TRUST BENEFICIARIES BE CONSIDERED A SEPARATE "CUSTOMER" AND THUS ENTITLED TO THE MAXIMUM COVERAGE PROVIDED UNDER SIPA.

The Plain Language of SIPA is Consistent with the Interpretation Adopted by the Courts Below

Section 6(c)(2)(A)(ii) of SIPA defines "customers" of a debtor as:

> ". . . persons (including persons with whom the debtor deals as principal or agent) who have claims on account of securities received, acquired, or held by the debtor from or for the account of such persons (I) for safekeeping, or (II) with a view to sale, or (III) to cover consummated sales, or (IV) pursuant to purchases, or (V) as collateral security, or (VI) by way of loans of securities by such persons

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* See Bank of Marin v. England, 385 U.S. 99 (1966); 1 Collier on Bankruptcy ¶ 2.09 (1974).

> to the debtor, and shall include persons who have claims against the debtor arising out of sales or conversions of such securities, and shall include any person who has deposited cash with the debtor for the purpose of purchasing securities, but shall not include any person to the extent that such person has a claim for property which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor or is subordinated to the claims of creditors of the debtor; . . ."

Each of the 108 trust beneficiaries is a person who has a claim on account of the free credit balance owed to the Trust by the Debtor on the date of bankruptcy. On its face, the statute is silent as to whether trust beneficiaries should be treated as separate "customers" for purposes of the insurance coverage provided by SIPA.

SIPC's argument that a "customer" must be someone who deals directly with the bankrupt broker-dealer (Appellant's Brief at pp.12-15) is not supported by the language of the statute. The definition of "customer" appearing in Section 6(c)(2)(A)(ii) refers to "persons who have claims" on account of certain enumerated transactions with a bankrupt broker-dealer. The definition does not, as SIPC would have this Court believe, require that such persons be "persons with whom the debtor deals". Rather, the definition focuses on the word "persons" which is thereafter modified by the phrase "including persons with whom the debtor deals" [emphasis added]. Thus, the definition clearly indicates that the protected customers are both persons who have dealt with the debtor and persons who have not dealt directly with the debtor but who nevertheless have claims arising from transactions conducted on their behalf.

SIPC urges that the definition of "net equity" (Section 6(c)(2)(A)(iv)) also requires the conclusion that "customers" must have dealt with the debtor and that "the notion of a conventional customer pervades [Section 6] in its entirety" (Appellant's Brief at p.14). However, its own Series 100 Rules (3 CCH Fed. Sec. L. Rep. ¶ 26,667), which were promulgated specifically for the purpose of determining "what accounts held with a member of SIPC" are to be deemed accounts of a "separate customer", specifically acknowledge that there are instances where a person who has not actually dealt with the debtor is entitled to SIPA coverage. For example, Rule 101(b) provides that an account held by an agent or nominee is deemed, for purposes of insurance coverage, to be the individual account of the principal or beneficial owner of the account. Furthermore, the definition of the word "customer" must necessarily be broad enough to encompass persons on whose behalf broker-dealers or banks execute transactions with bankrupt broker-dealers, since such persons are "deemed separate customers of the debtor" by Section 6(f)(1)(B) of SIPA and thereby are entitled to individual coverage. These "customers" need have no direct dealings with the debtor.

Congressional Intent Regarding
<u>Insurance Coverage Under SIPA</u>

The provisions of SIPA are unclear and ambiguous in many respects. <u>Securities and Exchange Commission</u> v. <u>Aberdeen Securities Co., Inc.</u>, 480 F.2d 1121, 1123 (3d Cir. 1973), <u>cert</u>. <u>denied</u>, 414 U.S. 1111 (1973).

Although both SIPC and the Securities and Exchange Commission have been given authority to formulate rules and regulations regarding the administration of SIPA (Sections 3(b)(3) and 3(e)(3)), neither has yet enacted guidelines defining the coverage of beneficiaries of trustee accounts. In view of this lack of specificity, this Court will, as did the courts below, look to the intent of Congress.

Congress, in enacting SIPA, sought to protect the small investor.

> "Today the Securities Subcommittee will begin hearings on legislation, introduced by Senator Muskie, which would create a Federal Broker-Dealer Insurance Corporation.
>
> "The need to protect the many millions of Americans who leave their securities with broker-dealers for safekeeping, who have free credit balances and who must be protected against fails to deliver has intensified over the last several months.
>
> "Some of our Nation's largest brokerage firms have reported losses of up to $8.9 million in 1969. The insolvency of any large firm could create havoc in the securities industry due to the interrelationship between broker-dealers.
>
> "The real losers would be the small investors, many of whom have invested a significant portion of their savings in securities. It is imperative that these investors be fully protected against brokerage firm failures. [Emphasis added.]*

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* Hearings on S. 2348, S. 2988, S. 2989 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 1 (1970) (the "Senate Hearings").

The factory workers and employees of Reading Body Works are small investors, the kind of investors that Congress sought to protect. Each of these investors had a vested and separately ascertainable interest in the corpus of the Trust. Each individual "owned" a portion of the amount owed to the Trust by the Debtor.

Congress sought to "afford maximum protection to the preponderant majority of small investors" (Memorandum Order at A 59) rather than to the total dollar amounts of money and securities held by firms in safekeeping.* The interpretation of SIPA advanced by the Trustee is consistent with extending coverage to the greatest possible number of small investors.

Liquidation and Insurance

An integral aspect of the legislative scheme embodied in SIPA is limited insurance protection for the customers of bankrupt broker-dealers.** Congress chose to remedy the loss of public confidence in the securities markets occasioned by the bankruptcy of broker-dealers by

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* Hearings on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, H.R. 18458 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong. 2d Sess., 339-340 (1970) (the "House Hearings").

** Senate Hearings at p. 2; House Hearings at pp. 1, 221-222, 367, 369-70 and 376; Senate Report No. 91-1218, 91st Cong., 2d Sess. 1 (1970).

creating federal insurance for investors. Despite SIPC's contention (Appellant's Brief at p. 20) that the "SEC made a 'studied decision' to abandon the FDIC concept" the scheme finally adopted is similar in every respect relevant here to other insurance statutes previously enacted by Congress (e.g. FDIA and FSLIA).* The only substantive differences from

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* Like SIPA, both the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. §§ 1811, et seq.) and the Federal Savings and Loan Insurance Act ("FSLIA") (12 U.S.C. §§ 1724, et seq.) provide for the establishment of corporations which are to maintain funds out of which the deposits and accounts of member institutions are insured. In all three cases insurance funds have been established with member assessments or premiums and the corporations are authorized to borrow up to specified amounts from the United States Treasury to meet their additional insurance needs. All three schemes provided limited protection to depositors or customers.

That Congress based the insurance provisions of SIPA upon the provisions of FDIA and FSLIA and intended them to provide the same kind of insurance protection to investors is made abundantly clear in the legislative history of SIPA.

> "This morning we commence hearings on H.R. 13308, and H.R. 17585, bills to establish a Federal broker-dealer insurance corporation. The corporation would be similar to the existing Federal Deposit Insurance Corporation in that it would be set up as a separate tax-exempt entity, funded initially with loans from the U.S. Treasury. The corporation would insure customer accounts with broker-dealers, in order to insure against customer losses due to financial collapse of the broker-dealer. There has been a need for congressional attention to this important subject for some time now, and events of the past months have, if anything, only heightened that need."
> House Hearings, p. 1

these other statutes result from the fact that the SIPA insurance provisions were engrafted onto the previously enacted bankruptcy provisions contained in Section 60(e) of the Bankruptcy Act (11 U.S.C. § 60(e)). Securities and Exchange Commission v. Aberdeen Securities Co., Inc., supra.

Insurance for investors was without precedent in previous bankruptcy law. SIPC's brief relies on the history and origin of the bankruptcy law as a basis for the interpretation of the word "customer" under SIPA (Appellant's Brief at pp. 8-11). This reliance is wholly unjustified. Since Section 60(e) of the Bankruptcy Act contained no insurance provisions, it is inappropriate to consult the usage of the terms used therein as authority for the insurance aspects of SIPA. The authorities relied upon by SIPC are therefore irrelevant and shed no light on how the term "customer" should be interpreted.

In a Section 60(e) liquidation proceeding, the fact that an account was maintained by a trustee rather than an individual was of no consequence. Each customer was entitled to receive a pro rata share of the single and separate fund based on the dollar amount of the property contained in his account. There was no need to look behind the account to the number of individuals beneficially interested therein. The claim at issue here would have received no greater a share of the total distribution whether the trustee under Section 60(e) treated it as a single claim or the claim of 108 persons.

The grafting of insurance provisions onto the liquidation provisions of Section 60(e) of the Bankruptcy Act necessitated for the first time an inquiry into the nature of the entities maintaining broker-dealer accounts. The necessity for such inquiry is clearly evidenced by SIPC's promulgation of the Series 100 Rules. These Rules were enacted by SIPC in order to determine what accounts held with SIPC members would be deemed accounts of separate customers. There was no need for such a determination under the prior liquidation provisions because there was no insurance coverage.

Insurance and Regulation

SIPC notes that while "FDIC has vast regularity authority over banks" (Appellant's Brief at pp. 20 and 21), SIPC has no such authority over its members, and concludes that this difference is "more than sufficient to justify the clear congressional determination to limit protection in the manner it did." The extent to which SIPC can regulate its members is unrelated to the question of insurance coverage. As is amply demonstrated in SIPA's legislative history (House Hearings at pp. 167, 198 and 199), Congress chose to divide the insurance and surveillance functions of the regulatory scheme between SIPC on the one hand and the Securities and Exchange Commission ("SEC") and the self-regulatory agencies on the other. SIPC's assertion that membership in SIPC is "automatic" and that it has no power to terminate membership "no matter what unsafe or unsound

practices the broker-dealer may engage in" (Appellant's Brief at p. 21) is technically correct but highly misleading. SIPC membership automatically attaches to brokers or dealers which are either registered under Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. § 78o(b)) or members of a national securities exchange (Section 2 of SIPA). The SEC and the exchanges are charged with assuring that such brokers and dealers meet the high standards of financial responsibility set forth in the securities laws.

FDIA and FSLIA

FDIA and FSLIA offer protection up to a specified limit (now $40,000) for each "insured deposit" or account in an insured institution. The applicable regulations promulgated by both FDIC and FSLIC provide each vested beneficiary of a trust which maintains an account at an insured institution with separate coverage up to the prescribed maximum. The Appendix to the FSLIC Regulations provides as follows:

> "Trust accounts. A trust estate is the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, that is valid under State law. Thus, funds deposited in an account by a trustee under an irrevocable express trust are insured on the basis of the beneficial interests under such trust. The interest of each beneficiary in an account (or accounts) established under such a trust arrangement is insured to $40,000, separately from other accounts held by the trustee, the settlor (grantor) or the beneficiary.
>
> *   *   *

Question: T is a trustee of an irrevocable trust created by S, settlor, for the benefit of A and B in equal shares. T holds an account containing $80,000 in trust funds. A and B, as well as T and S, each maintain individual accounts in the amount of $40,000 each. What is the insurance coverage?

Answer: The trust estates of A and B invested in the account are each insured to the $40,000 maximum, assuming that neither A nor B have beneficial interests in any other accounts established pursuant to an irrevocable trust created by the same settlor. Since A and B have equal beneficial interests under the trust, each has a proportionate interest in the trust account of $40,000, and the account is fully insured. The individual accounts of A, B, T, and S are each separately insured to $40,000 (§ 564.10)." 12 C.F.R. § 564 - Appendix (1975).*

The purpose of the FSLIC and FDIC Regulations is to define the term "insured account" and "insured deposit," respectively, terms used by FSLIA and FDIA to designate accounts entitled to separate insurance coverage. The Trustee submits that in order to achieve the purposes of SIPA the term "customer" under SIPA ought to be similarly defined.

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* The FDIC Regulations which appear at 12 C.F.R. § 330 - Appendix (1974) contain a practically identical provision and example. Due to the increase in coverage from $20,000 to $40,000 which necessitated a revision of the Appendix examples, the FDIC Regulations printed in 1975 omitted the Appendix. The Appendix will, however, be revised to account for the $40,000 maximum coverage and published sometime during 1975.

The FDIC and FSLIC Regulations also set forth the treatment to be accorded deposits and accounts maintained by agents or nominees, individuals jointly, partnerships, corporations and executors and administrators of estates (12 CFR §§ 330 et seq. and 12 CFR §§ 546 et seq.) In each case these regulations require that each such deposit or account be deemed a single deposit or account for purposes of insurance coverage. In each such case SIPC's Series 100 Rules provide for the same degree of coverage.

The reason for a difference in coverage as between accounts maintained by executors and accounts maintained by trustees results from a difference in the nature of the beneficiary's interest. Under the FDIC and FSLIC Regulations, interests of beneficiaries of irrevocable trusts which are presently vested, are insured as separate accounts, whereas the interests of beneficiaries under wills, which cannot vest until the estates are closed, are not insured as separate accounts. See Phair v. Federal Deposit Insurance Corp., 74 F. Supp. 693 (D. N.J. 1947).

The insurance provisions of FDIA, FSLIA and SIPA all have the same purpose. Each was enacted to provide limited protection to people who entrust their money or securities to banks, savings and loan institutions or broker-dealers. In view of this similarity and in view of the identical treatment accorded accounts other than trust accounts under all three legislative schemes, there is no justification for creating an exception under SIPA with respect to the coverage of fully vested trust accounts.

SIPC's arguments for ignoring the FDIC and FSLIC analogies in this regard are not compelling. SIPC asserts that Congress' failure to adopt several of SIPA's predecessors* which were "patterned after the FDIC" represents a conscious decision to reject separate coverage for beneficial trust interests (Appellant's Brief at p. 19). A better explanation is that the FDIC models were not suited to "engraftment . . . upon the preexisting Section 60(e) bankruptcy provisions" SEC v. Aberdeen Securities Co., Inc., supra. The fact that three of the earlier bills contained provisions which looked through formal account designations to the beneficial interests for purposes of insurance coverage does not imply a conscious rejection of multiple coverage for trust interests. The fact that there is not one word in the published hearings which remotely touches on this narrow issue, strongly indicates that it was never specifically considered in passing upon SIPA in its final form.

The legislative history of SIPA shows that, to the extent differences between bank depositors and broker-dealer customers were analyzed, Congress recognized a need for greater insurance coverage for brokerage customers.

> "The Board notes that the manner in which insurance by SIPC is applied in both bills is more generous than coverage afforded depositors by the

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* S. 2348, and, as amended, H.R. 13308 and H.R. 17585.

> FDIC and FSLIC. The Board recognizes, however, that coverage of customers of broker-dealers cannot be entirely parallel to that afforded depositors in banks, because the broker performs a custodial function--as an integral part of customer account services--in holding customers' fully paid securities in safekeeping. The accounts of customers of broker-dealers thus reflect partly depositary claims (credit balances) comparable to claims insured by FDIC and partly custodial claims comparable not to deposits but to bank trust accounts." [Letter from J. L. Robertson, Vice Chairm., Board of Governors of the Federal Reserve System.] House Hearings at p.146.
>
> "The $50,000 was included in the original bills which were introduced by Chairman Moss, and by Senator Muskie. The figure has been used pretty much ever since. It seems to us, particularly in light of the material which we have submitted to the record this morning, that $50,000 is a reasonable fee. It is higher than the banks and savings and loan limitation but perhaps could be justified on the basis that people, depositors may deposit in one or several banks or savings and loan and obtain this further coverage, but there are very few people who do business with more than one broker.
>
> So, we felt that the $50,000 fee as compared with the $20,000, limitation in the other field is a proper one." [Statement by Hamer H. Budge, Chairman, Securities and Exchange Commission.] House Hearings at p. 376.

<u>SIPC's Series 100 Rules are Wholly Consistent with the Interpretation Advanced by the Trustee</u>

SIPC argues that the Series 100 Rules "serve a very limited purpose" and seeks to minimize their importance and authority (Appellant's Brief at pp. 21 and 22). In Fact, these rules are closely patterned after both the FDIC and FSLIC Regulations and serve similar functions. As already noted (<u>supra</u> at p.16), the Series 100 Rules treat nominee,

joint, corporate, partnership and testamentary accounts the same as do the FDIC and FSLIC Regulations. SIPC contends that the relevant statutory definitions contained in SIPA are unambiguous in this regard and cites the defining power granted to FDIC in 12 U.S.C. § 1813 as evidence that the operative terms of FIDA are in need of further definition (Appellant's Brief at p. 20). The length and specificity of SIPC's own Series 100 Rules, all directed toward the clarification of the single term "separate customer," amply demonstrates that SIPC's assertion is unfounded.

As District Judge Frankel aptly pointed out in his Memorandum Order (A 58), two provisions of the Series 100 Rules (Rules 101(b) and 104(c)) look to "the individual human 'beneficiary' as the measure of protection" rather than the formal account designation. In demanding consistency of SIPC, District Judge Frankel concluded:

> "That approach should not be shunned when it is favorable to the real party in interest--the true investor with his small but vital stake--and adopted only when it hurts. The overriding purpose remains after all to effect 'the speedy return of most customer property.' Securities Investor Protection Corp. v. Barbour, 43 U.S.L.W. 4630, 4631 (May 19, 1975)." (Memorandum Order at A 59).

Beneficiary Rights Under Section 10(b)
of The Securities Exchange Act of 1934

The right of trust beneficiaries to bring separate causes of action under certain circumstances to protect their interests is well established. In James v. Gerber Products Co., 483 F.2d 944, 949 (6th

Cir. 1973) the Sixth Circuit held that the beneficiaries of a trust had standing to sue as separate claimants under Section 10(b) of the Securities Exchange Act of 1934, to which SIPA is to be treated as an amendment (see Section 2 of SIPA). In that case the Court stated:

> " . . . separating the legal and beneficial incidents of ownership in the [trust] property is a mere technical argument since there is only one interest at stake and that is the beneficiary's."*

Liability of Broker-Dealers to Trust Beneficiaries Under the Employee Retirement Income Security Act of 1974

Section 502 (29 U.S.C. § 1132) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1001 et seq.) ("ERISA") expressly permits the beneficiaries of employee benefit plan trusts to sue plan fiduciaries for various kinds of relief. Section 502 (a) in part provides:

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* Accord, Heyman v. Heyman, 356 F.Supp. 958, 965 (S.D. N.Y. 1973) and Local 734 Trust v. Continental Illinois National B&T Co., CCH Fed. Securities Law Reporter, 1973-74 Transfer Binder, ¶ 94,565 (N.D. Ill. 1974). See also, Section 12(g)(2)(H) of the Securities Exchange Act of 1934 and Section 316(b) of the Trust Indenture Act of 1939 as examples of Congressional concern for the rights of trust beneficiaries.

"A civil action may be brought--(1) by a participant or beneficiary--

* * *

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

* * *

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;"

Section 409(a) of ERISA (29 U.S.C. § 1109(a)) makes a fiduciary personally liable for losses resulting from any breach of his obligation under the non-tax provisions of the Act.

A fiduciary is defined in § 3(21)(A) of ERISA (29 U.S.C. § 1002(21)(A)) as anyone who exercises discretionary authority respecting management or disposition of the plan's assets. Thus ERISA expressly gives any beneficiary the right to sue any plan fiduciary who breaches his obligations under ERISA and allows him to recover the losses suffered in his own account. To the extent that a broker-dealer may be deemed a plan fiduciary under ERISA the beneficiary's rights of action would extend against broker-dealers.

This attention to the rights of trust beneficiaries under ERISA is an indication of Congressional concern with the vested rights of employee plan beneficiaries. It is submitted that Congress also intended that the employees of the Company have the same rights with respect to SIPC coverage.

POINT II

APPELLANT'S PREDICTIONS AS TO THE ADVERSE FINANCIAL IMPACT ON SIPC IF THE DECISIONS BELOW ARE UPHELD ARE WITHOUT RELEVANCE HERE AND APPELLANT'S AUTHORITIES OFFER NO SUPPORT FOR ITS VIEW THAT TRUST ACCOUNTS SHOULD BE TREATED AS SINGLE "CUSTOMERS" REGARDLESS OF THE NUMBER OF BENEFICIAL INTERESTS REPRESENTED

Financial Burden on SIPC

The possibility of unknown and unlimited liability to SIPC's funds if trust beneficiaries are entitled to separate coverage is not a proper consideration in the determination of the coverage to be given trust interests under SIPA. The insurance provisions of SIPA by their nature subject the SIPC insurance fund to unknown and unlimited liability. The size and frequency of broker-dealer collapses are unpredictable. SIPC notes that if each of the 108 beneficiaries herein had a claim for securities of $50,000 "the construction adopted below would wipe out almost 10% of the SIPC Fund" (Appellant's Brief at p. 25). By the same token, one bankrupt broker-dealer with only 108 customers poses the same potential threat to SIPC's resources. The Debtor had over 3,700 customers, some 1,400 of whom filed claims in the liquidation proceeding.

There is no factual basis contained in the record herein for this Court to consider the effect, if any, that an affirmance of the orders of the lower courts would have on the payments made by SIPC in subsequent liquidations conducted by it.

FDIC has been providing separate coverage to trust beneficiaries since it was established in 1934. Surely if such coverage had imposed too great a burden on FDIC it would have been specifically eliminated by Congress in one of the numerous amendments to FDIA. In any case, SIPC's fears regarding vast potential liability are, as a practical matter, unfounded. Trustees, in general, are discouraged from leaving trust securities with broker-dealers. For example, in New York it is a misdemeanor for an individual fiduciary to register securities in brokerage house street names. McKinneys EPTL § 11-16; In re Estate of Simons, 61 Misc. 2d 550; 306 N.Y.S.2d 232 (Sur.Ct.1969).

Appellant's Authorities

Appellant cites several cases (Appellant's Brief at pp.18 and 19) for the proposition that accounts similar to trustee accounts have been treated in a manner consistent with its view. However, none of these cases concerned accounts maintained by trustees and accordingly none have bearing on the issue at hand.

Specifically, SIPC cites and makes special note of SIPC v. J. Shapiro Co., 473 Civ. 212 (D. Minn., March 18, 1975) (Appellant's Brief at p. 19). This case concerned the claim of an executrix based upon an account maintained with a bankrupt broker-dealer. One of the claimant's contentions was that the two beneficiaries under the decedent's will were each entitled to coverage as separate customers. The Court ruled that the

executrix's account be deemed a single "customer" and thus entitled to maximum coverage of $20,000. This ruling was based upon the fact that Rule 102 of the Series 100 Rules deals specifically with accounts maintained by executors or administrators and provides that all accounts in the name of a decedent be combined to constitute a single account of a separate customer. This case is not inconsistent with the Trustee's position that the FDIC and FSLIC analogies be followed in SIPC cases since, as noted above, the regulations promulgated by FDIC and FSLIC both provide that accounts maintained by executors and administrators are entitled only to coverage as single accounts regardless of the number of beneficial interests.

CONCLUSION

SIPC's arguments in this appeal hinge upon its assertion that Congress consciously chose to exclude multiple coverage of trust interests from the insurance provisions of SIPA. The text of the statute and the legislative history contain no evidence of such a conscious choice. Rather, the statute does not specifically define "customer" to include or exclude trust beneficiaries. Therefore, this Court should, as did the courts below, consult "the underlying policies and relevant analogies" (Memorandum Order at A 58) in formulating a rule for trust interests. Congress intended to follow the basic provisions of FDIA and FSLIA in providing protection to the greatest possible number of small investors. The interpretation urged herein and adopted below furthers that intent.

Therefore, it is respectfully requested that this Court affirm both the Order of Bankruptcy Judge Babitt and the Memorandum Order of District Judge Frankel that the claim of the Reading Trustees be deemed the separate claims of the 108 individual beneficiaries of the Trust.

Dated: New York, New York
October 2, 1975

Respectfully submitted,

ROGERS & WELLS

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OF COUNSEL:

Roberta S. Karmel
Laurence E. Cranch

Solomon, Esq., the Securities and Exchange Commission and the Securities Investor Protection Corporation, by causing the same to be transmitted to each of them by United States mail.

Laurence E. Granch

Sworn to before me this
2nd day of October, 1975.

Notary Public

ROBERT TURNER
NOTARY PUBLIC, State of New York
No. 03-4571359
Qualified in Bronx County
Certificate filed in New York County
Commission Expires March 30, 1976

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- -X

SECURITIES INVESTOR PROTECTION CORPORATION, :

Applicant-Appellant, :

SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

MORGAN, KENNEDY & CO., INC.; IRWIN RUDNET; and GERALD RUDNET; :

Defendants-Appellees, :

CLAIM OF READING BODY WORKS, INC. PROFIT SHARING PLAN TRUST, :

Claimant-Appellee.

- -X

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

LAURENCE E. CRANCH, being duly sworn, deposes and says:

1. I am an attorney associated with the firm of Rogers & Wells, 200 Park Avenue, New York, New York 10017, counsel to Eugene L. Bondy, Jr., Trustee for the liquidation of the business of Morgan, Kennedy & Co., the Debtor herein.

2. On October 2, 1975 I caused the annexed Brief of Appellee in the above-captioned proceeding to be served upon Charles H.

Solomon, Esq., the Securities and Exchange Commission and the Securities Investor Protection Corporation, by causing the same to be transmitted to each of them by United States mail.

Laurence E. Cranch

Sworn to before me this
2nd day of October, 1975.

Notary Public

ROBERT TURNIER
NOTARY PUBLIC, State of New York
No. 03-4521356
Qualified in Bronx County
Certificate filed in New York County
Commission Expires March 30, 1976